No. 89-1620

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC., NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS, NEW YORK STATE ASSOCIATION OF LIFE UNDERWRITERS, INDEPENDENT INSURANCE AGENTS OF NEW YORK, INC., AND THE PROFESSIONAL INSURANCE AGENTS OF NEW YORK, INC.,

Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND MERCHANTS NATIONAL CORPORATION,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF THE AMERICAN COUNCIL OF LIFE INSURANCE AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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INTEREST OF THE AMICUS CURIAE

The American Council of Life Insurance ("ACLI") is a trade association of 616 stock and mutual life insurance companies. Collectively, ACLI represents a total of approximately 94 percent of the nation's life insurance

companies. ACLI has long been active in administrative, legislative, and litigation matters regarding the permissible scope of bank insurance activities. *Amicus* has a strong interest in this case because its members likely will suffer substantial competitive injury if the order of the Federal Reserve Board ("Board"), as affirmed by the court of appeals, is not reviewed. *Independent Insurance Agents of America, Inc. v. Board of Governors*, 890 F.2d 1275 (2d Cir. 1989).[1]

By permitting bank subsidiaries of bank holding companies to sell insurance products, the Board misinterpreted Congress' clear direction that bank holding companies and their subsidiaries shall not generally engage in insurance related activities. The Board's order erodes the barriers between banking and insurance which Congress erected to ensure stability and fairness in financial markets, and in the insurance industry. Because the Board's order creates a major loophole in the Bank Holding Company Act ("the BHC Act" or "the Act"), its significance extends far beyond the ability of banks to sell insurance.

If this Court does not review the Board's order, it risks the degradation of the nation's banking system into a chaotic patchwork of competing state regulations. By acquiring a subsidiary bank in the correct state, bank holding company systems will be free to plunge into nationwide insurance underwriting activities that Congress has judged too risky for banks in holding company form. Indeed, under heavy pressure from banking interests, states already have begun a "race for the bottom," with the "winners" expanding greatly the powers of state-chartered banks. The resulting expansion of bank holding company activities is precisely what Congress in-

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[1] Pursuant to Rule 37 of the Rules of the Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

tended to prohibit through the Bank Holding Company Act.

SUMMARY OF THE ARGUMENT

The Bank Holding Company Act of 1956 regulated bank holding companies that previously had been free to engage in nonbanking as well as banking activities. Congress observed that the assimilation of independent banks into large holding company conglomerates allowed bank holding companies to magnify their economic power and embark on nationwide commercial ventures. Recognizing that such activity could pose a substantial danger to the soundness of the banking system and to the competitive position of commercial enterprises that were not part of a financial institution conglomerate, Congress adopted the BHC Act to restrict bank holding companies to banking and "closely related" activities. In so doing, Congress carefully balanced competing policy concerns: it permitted independent banks to choose whether to enjoy the benefits of bank holding company affiliation, but prohibited those that did so from engaging in commercial, nonbanking activities.

The Board's order destroys this legislative balance. The Board now disclaims any authority to prevent a bank subsidiary of a bank holding company from engaging in nonbanking activities. Yet the Board continues to claim the power to prevent commercial activities by (i) nonbank subsidiaries of a bank holding company, (ii) nonbank subsidiaries of a bank subsidiary of a bank holding company, and (iii) a bank holding company.

This "perplexing" result suffers from several critical flaws. *First*, the decision below essentially disregards the entire purpose of the BHC Act, and creates a mechanism for avoiding that statute by transferring otherwise forbidden activities to a state bank in any state permitting the activity. Indeed, the decision below perversely maximizes the resulting risks to banks, to depositors, and to federal deposit insurance.

Second, by inciting states to curry favor with powerful banking interests in order to attract or maintain banking industry jobs and tax revenues, the Board's order is a powerful spur in a regulatory "race to the bottom" that undermines uniform national regulation of bank holding companies. The resulting legal patchwork will be the opposite of the uniform national regulation which Congress intended.

Finally, in affirming the Board's order, the court of appeals recognized some of its irrationality, but erroneously deferred to the Board's construction of the statute. That judicial abdication was based on an unfortunate misunderstanding of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). As this Court reaffirmed in *INS v. Cardoza-Fonseca*, 480 U.S. 421, 449 (1987), deference to agency policy does not arise under *Chevron* until the court has employed the "traditional tools of statutory construction" —including "analysis of the plain language of the Act, its symmetry [with other legislation], and its legislative history." Those traditional tools of statutory construction establish the Board's error in this case. Moreover, no deference should be given to inconsistent agency interpretations—and the Board's order is contradicted by the Board's own regulations.

Because this case involves issues that are vitally important to the nation's bank regulatory system, and because its practical ramifications for banking and nonbanking industries alike are profound, this Court should grant certiorari.

ARGUMENT

I. CONGRESS ENACTED SECTION 4 OF THE BANK HOLDING COMPANY ACT TO LIMIT BANK HOLDING COMPANY COMPLEXES TO BANKING AND ACTIVITIES "CLOSELY RELATED" TO BANKING

In section 4 of the Bank Holding Company Act, Congress forbade bank holding companies and their subsidiaries generally from "engag[ing] in any activities other than (A) those of banking . . . and (B) those . . . [activities which are] so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843. Under section 4, bank holding companies may "acquire" or "retain", either directly or indirectly, only "banks" and other companies engaged in activities "so closely related to banking . . . as to be a proper incident thereto." *Id.*

The principal question here is whether the Act's prohibition on non-banking activity by bank holding companies applies to the actual banks owned by the bank holding companies. The court of appeals concluded that no statutory phrase definitively resolves this question. 890 F.2d at 1281. Although the Act's terms provide square support for petitioners' construction, Pet. at 15-17, the Board's order is glaringly inconsistent with the goals, legislative history and policy of the Bank Holding Company Act. No clever parsing of words and phrases can justify a decision that is so totally at war with the underlying thrust of the statute being interpreted.

A. The Goals And Legislative History Of The Bank Holding Company Act Are Directly Contrary To The Decision Below

Beginning in the 1950s, Congress became concerned that the nation's banking system was being misused and undermined by unregulated holding companies which combined both banks and completely unregulated non-bank companies. Congress concluded that this combina-

tion of bank and nonbank companies posed distinct dangers for the national economy, including: (i) the risks to banks whose fate became intertwined with the nonbanking commercial activities of the holding company; (ii) the linking of bank credit to patronage of the holding company's nonbanking enterprises; and (iii) the increased economic power of banks that became part of holding company conglomerates. *See* S. Rep. No. 1095, 84th Cong., 1st Sess. 5, 10, 14, *reprinted in* 1955 U.S. Code Cong. & Admin. News 2482, 2486, 2491-92, 2495; *see* H.R. Rep. No. 609, 84th Cong., 1st Sess. 16-17 (1955). In order to minimize these dangers, Congress approved the 1956 Act.

The Act aimed to halt the misuse of and damage to the banking system by codifying for bank holding companies the core principle that "banking institutions should not engage in business wholly unrelated to banking." S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955); *see also* H.R. Rep. No. 609, 84th Cong., 1st Sess. 16 (1955). As this Court has observed, one of the "primary objectives" of the 1956 Act was "to implement a congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980).

The Act's legislative history amply reflects the congressional purpose to require the divestiture not only of nonbanking "companies" but also of nonbanking "enterprises," "interests," "businesses," and "activities" generally. *See, e.g.*, S. Rep. No. 1095, 84th Cong., 1st Sess. 1, 4, 5, 13-14, 21. Conversely, the legislative history is devoid of any indication that Congress intended to permit *any* component of a bank holding company complex, including bank subsidiaries, to engage in any activity other than banking or activities closely related to banking.

Later Congresses have confirmed the view that the 1956 Act prohibits nonbanking activities conducted di-

rectly by the holding company *or* through a subsidiary. For example, in 1970 Congress extended the Act to bank holding companies with only one constituent bank. At the same time, Congress enacted a "grandfather" exception providing that a bank holding company may continue to "engage in those activities in which *directly or through a subsidiary . . . it was lawfully engaged* on June 30, 1968." 12 U.S.C. § 1843(a)(2) (emphasis supplied). The 1970 statute also gave the Board the power, under certain circumstances, to "terminate the authority conferred" by this proviso. Congress thus understood that the 1970 grandfather provisions "conferred" on a few institutions the authority to carry on commercial activities through subsidiaries, and that the general prohibition of Section 4(a)(2) otherwise barred the conduct of such activities through subsidiaries.

In 1982 amendments, Congress directed that general insurance activities, with limited exceptions, are too far removed from banking to be conducted by bank holding companies. Garn-St Germain Depositary Institutions Act of 1982, Pub. L. No. 97-320, § 607, 96 Stat. 1469, 1536-38 (1982). Congress thus repeated one more time its insistence that banking institutions and their depositors must be protected from the adverse financial consequences that could arise from business activities wholly unrelated to banking. The Conference Report confirms that the 1982 amendments "generally prohibit[] bank holding companies *and their subsidiaries* from providing insurance." H.R. Conf. Rep. No. 899, 97th Cong., 2d Sess. 9 (1982) (emphasis supplied). The conclusiveness of this passage is underscored by the Act's definition of "subsidiary," which explicitly encompasses "banks." 12 U.S.C. § 1841(b-d). Surely, if the Conference Committee had intended to refer only to nonbank subsidiaries, it would have done so.

B. *Merchants National* Perversely Maximizes The Risk Of Non-banking Activities

The Board's order yields the completely perverse outcome that non-banking activities may be conducted directly in the bank, where the risk to depositors and federal deposit insurance funds is *greatest*. Were a bank to engage in commercial ventures through a subsidiary, the limitation upon liability provided by the corporate form would insulate the bank's assets from the bank's nonbanking losses. But the Board's order ensures that no such protection will be available, thus maximizing the risk of loss to depositors and taxpayers. *See also* Blueprint for Reform: The Report of the [Bush] Task Group on Regulation of Financial Services (1984), Fed. Sec. L. Rep. (CCH) No. 1099, Pt. 2 at 47 (noting the "importance of conducting nonbanking activities in separate holding company subsidiaries rather than in the bank itself"); 50 Fed. Reg. 23,964 (June 7, 1985) (FDIC advocated prohibiting insured banks from directly engaging in insurance). This result is precisely the opposite of Congress' intent to protect banks, depositors, and federal deposit insurance from the risk of commercial nonbanking activities.

The perversity of this outcome was recently underscored by—of all people—the Chairman of the Federal Reserve System, who expressed concern that "permitting banking organizations to engage in a larger number of activities will spread the [federal deposit insurance] safety net ever wider and wider through a network of bank affiliates." Remarks before the Annual Conference on Bank Structure and Competition, May 10, 1990, pp. 10-11. The Chairman warned banks *not* to conduct high-risk activities directly in the bank, but to build "firewalls" protecting the bank's assets by placing high-risk activities in separate subsidiaries (*id.* at 11):

> [s]uch an extension [of the deposit insurance safety net] would threaten to intensify the adverse effects

of suppressing market signals, and raise questions about what the safety net is designed to protect. By design, firewalls should avoid the extension of the safety net, keeping it under the commercial banks alone.

The Board's order flies in the face of the Chairman's wise counsel, compelling bank holding companies to conduct risky nonbanking activities directly within their subsidiary banks, with no "firewalls" at all. This case illustrates this perverse process. It began with an application by Merchants National Corporation ("Merchants") to acquire Mid-State Bank of Danville, Indiana ("Mid-State"), which had conducted insurance agency business through a wholly-owned subsidiary. Merchants initially proposed that Mid-State conduct the insurance agency activities through its subsidiary, leaving intact the "firewall" between the bank and the insurance activity of its subsidiary. But Merchants then amended its proposal to bring the insurance activities directly into the bank, with no firewall at all, in order to avoid the nonbanking prohibitions of the BHC Act. 75 Fed. Res. Bull. 388, 390 n.9 (1989). Nothing in the statutory text or legislative history supports this perverse outcome.

II. THE DECISION BELOW UNDERMINES NATIONAL REGULATION OF BANK HOLDING COMPANIES AND WILL TRIGGER A REGULATORY "RACE TO THE BOTTOM" AMONG THE STATES

Taking advantage of the loophole created by the Board's order, bank holding companies and their constituent state banks are spurring a headlong "race to the bottom" of bank regulation. Less than three weeks after the Board's decision, the minority leader of the Delaware General Assembly introduced legislation permitting Delaware-chartered banks to engage directly in every aspect of insurance underwriting and agency, and to do so on a nationwide basis. *See* "Banks Strike at Insurance Legislation While Iron is Hot," *The* [*Delaware*] *News Jour-*

nal, April 9, 1989, p. D3. With similar legislation already pending in California and Florida, Delaware legislators sought to act quickly to attract big bank holding companies to Delaware. *Id.*

In mid-May, while "more than a dozen bank lobbyists clogged the corridors of Delaware's Legislative Hall in Dover," the Delaware legislators adopted broad legislation authorizing state banks to underwrite insurance. "Delaware Bill Opens Insurance to Banks," *Wall Street Journal*, May 21, 1990, p. A4. This legislation was signed into law by Delaware Governor Michael Castle on May 29, 1990. 54 *BNA's Banking Report* 946 (June 4, 1990).

The *Wall Street Journal* reported (May 21, 1990, p. A4) that the Delaware legislation "opens the door to huge money-center and superregional banks," and that "state officials have backed the measure because it holds the prospect of generating thousands of new jobs." The Chase Manhattan Corporation has already announced plans to convert its $8 billion Delaware bank from a federal charter to a state charter in order to take advantage of the new Delaware legislation. *See* "Delaware to Allow Banks to Sell Insurance," *The New York Times*, May 31, 1990, p. D17. Citicorp, the nation's largest banking company, has also announced plans to begin underwriting insurance in Delaware—a business which Delaware officials have estimated may employ more than 300 people. *Id.*

The race to the bottom is not confined to Delaware. Twelve states reportedly are considering legislation to let banks engage in insurance. 54 *BNA's Banking Report* 724 (April 30, 1990).

In recent congressional testimony, the Conference of State Bank Supervisors reported that the race to the bottom is in full swing. Delaware and North Carolina permit banks to underwrite both securities *and* insurance, while three other states permit insurance under-

writing and fifteen other states allow securities underwriting.

Twenty-two states allow banks to engage in *both* real estate equity participation and real estate development—both of which also carry high risks. Three states allow banks to engage in insurance, securities *and* real estate brokerage, while four states permit banks to engage in two of those brokerage activities, and twenty-one more states grant banks the power to engage in at least one such brokerage activity. Gilleran, Statement Before House Subcomm. On Financial Institutions Supervision, Regulation And Insurance, Attachment 2 (April 4, 1990).

Effective federal oversight over the proper boundaries of bank holding companies will be effectively eliminated if holding company conglomerates may engage, through their component banks, in whatever activities the fifty states severally allow. Despite the undeniable risks associated with underwriting and real estate development, pressure from powerful banks will hasten the race to the bottom. Indeed, if the Board's order is allowed to stand, "banking" will no longer have any meaning under the Bank Holding Company Act, but will come to mean whatever any of the several states determines.

The savings and loan crisis vividly illustrates Congress' wisdom in prohibiting banks from straying into such risk-laden activities. Massive losses rendered the Federal Savings and Loan Insurance Corporation effectively insolvent and have prompted the President to call for a comprehensive overhaul of the federal deposit insurance system. *See* "Bush Savings Plan Calls for Sharing the Cost Broadly," *The New York Times*, Feb. 7, 1989, pp. A1, D8. These unprecedented losses, which ultimately will be absorbed by the taxpayers, have been caused in part by lax state laws that allowed thrifts to engage in high-risk activities not traditionally performed by savings institutions. *See, e.g.*, Federal Deposit Insurance Corporation,

Deposit Insurance for the Nineties: Meeting the Challenge, at 314 (draft edition, January 4, 1989). The Bank Holding Company Act announces a national policy of eliminating such risks for bank holding companies, but that policy is entirely frustrated by the decision below.

III. THE SECOND CIRCUIT MISAPPLIED *CHEVRON U.S.A., INC. v. NATURAL RESOURCES DEFENSE COUNCIL, INC.*

The first question for a court to consider when reviewing an agency's construction of a statute is "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter . . . ." *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). The need for independent examination of legislative intent by the reviewing court is clear and has constitutional underpinnings: "[t]he *judiciary* is the final authority on issues of statutory construction . . ." *Chevron*, 467 U.S. at 843, n.9 (emphasis supplied). *See also FEC v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 32 (1981); *Diamond v. Chakrabarty*, 447 U.S. 303, 315 (1980) ("once Congress has spoken it is 'the province and duty of the judicial department to say what the law is'"); *NLRB v. Brown*, 380 U.S. 278, 291-92 (1965); *Marbury v. Madison*, 1 Cranch 137, 177 (1803).

In determining whether the intent of Congress is clear, the reviewing court should employ "traditional tools of statutory construction," including examination of the applicable legislative history. *NLRB v. Food and Commercial Workers Union*, 484 U.S. 112, 124 n.20 (1987); *Cardoza-Fonseca*, 480 U.S. at 446 n.30. The second *Chevron* question—whether the agency's interpretation of the statute is reasonable—*never arises* if Congress' intent is clear.

The examination of Congress' intent must be more than merely perfunctory. This is particularly true where, as

here, the question involved is one of pure statutory construction and does not involve an agency's "formulation of policy [or] the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Cardoza-Fonseca*, 480 U.S. at 445-446 (quoting *Chevron*); *see also Food and Commercial Workers Union*, 484 U.S. at 123; *NLRB v. Brown*, 380 U.S. at 292.

The court of appeals did not apply these principles properly. Immediately after noting, in essence, that no magic words in the statute specifically apply the Act's nonbanking restrictions to *bank* subsidiaries of bank holding company complexes, the court opined that "[t]he question for us is whether the Board's interpretation of the language that does appear in the Act is reasonable . . . ." 890 F.2d at 1281. Thus, the court considered the legislative history of the Act *only* in the context of whether the Board's interpretation was reasonable. The court of appeals never did construe the statute in the light of Congress' plain intent.

Moreover, the court's deference to the Board was entirely misplaced, since the Board's order cannot be reconciled with the Boards' own regulations. To earn judicial deference, an agency's statutory construction must at least be consistent. *See Watt v. Alaska*, 451 U.S. 259, 273 (1981); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 858 n.25 (1975). But the Board has issued regulations under the Bank Holding Company Act which limit "a bank holding company *or a subsidiary*" to banking related activity. 12 C.F.R. § 225.21(a) (emphasis supplied). The regulations state that "subsidiary" has "the same meaning" in the regulations as in the BHC Act, which the regulations define as "a *bank* or other company that is controlled by another company, and refers to a direct or indirect subsidiary of a bank holding company." 12 C.F.R. § 225.2(m) (emphasis supplied). Thus, the Board's own regulations explicitly bar bank subsidiaries from nonbanking activity. The Board's order lamely attempts to wish away this fundamental in-

consistency by stating in a footnote that the regulation's "definition does not apply where the context otherwise requires." 75 Fed. Res. Bull. at 392, n.21. The Board never explains, however, what "context" suspends the regulatory definition for this case.

The Board has been more candid in admitting that its order is inconsistent with another regulation which allows a holding company bank to use a subsidiary to engage in any activity in which the bank itself legally may engage. This regulation, 12 C.F.R. § 225.22(d)(2)(ii), completely contradicts the Board's contention that subsidiaries of a bank may not engage in commercial activities; since the regulation states that subsidiaries can do whatever their parent banks can do, no such prohibition exists. Over a year ago, the Board admitted this inconsistency and proposed to revise the regulation to make it consistent with *Merchants National.* 53 Fed. Reg. 48,915 (December 5, 1988). Such regulatory incoherence, however, surely is entitled to no deference from the courts.

CONCLUSION

For all of the foregoing reasons, *amicus* urges that the petition for a writ of certiorari be granted and that the judgment of the Court of Appeals be reversed.

Respectfully submitted,

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